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Audit Case Number
96-SE-212-1001

TO: Thomas C. Cusack, Director, Multifamily Housing Division, 0EHM
Portland, Oregon

FROM: A. George Tilley, District Inspector General for Audit, 0AGA

SUBJECT: Report on Audit of DB&B, Inc.
Owner of Western Terrace Apartments, McMinnville, OR
and Colonial Court South Apartments, Albany, OR

At the request of the HUD Portland Multifamily Housing Division, we audited DB&B, Inc.'s operation of Western Terrace Apartments in McMinnville, OR and Colonial Court South Apartments in Albany, OR. HUD expressed concern over the deteriorating physical condition of the properties, certain financial transactions that had come to their attention, and DB&B, Inc.'s disregard of instructions from HUD to bring the projects' physical condition and financial records into compliance with HUD requirements. The purpose of our audit was to determine if DB&B, Inc. operated these properties in accordance with applicable HUD regulations and contractual agreements relating to the concerns expressed by HUD.

SUMMARY

Based on the results of our audit, we concluded that DB&B, Inc., owner of Western Terrace and Colonial Court South Apartments, disregarded HUD requirements and instructions in order to save funds for prepayment of their HUD insured mortgages. As a result of DB&B, Inc.'s disregard for HUD requirements, residents lived in substandard conditions and \$93,495 of HUD funds were used for ineligible or unsupported expenses. Specifically:

- DB&B, Inc. did not expend available reserve funds to maintain the properties. As a result, the residents of the properties were not provided decent, safe, and sanitary housing. DB&B, Inc. did not perform required maintenance because it was holding the funds to prepay the mortgages on the properties (see Finding 1, Attachment 2).
- Contrary to the regulatory agreement, HUD requirements, and specific instructions from the HUD Portland office, DB&B, Inc. improperly paid management fees to themselves and other unapproved property managers. As a result, \$23,678 of project operating funds were used to pay for inadequate property management. This occurred because DB&B, Inc. intentionally disregarded HUD rules and instructions (see Finding 2, Attachment 3).

- DB&B, Inc. did not properly maintain the projects' books and records, as required. As a result, DB&B, Inc. could not support that \$69,817 of project funds were used for eligible project expenses. Officers of DB&B, Inc. told us that they had not taken the time to properly maintain project books and records and document that the expenses were eligible; and that they had not obtained required financial audits because they planned to prepay the projects' HUD insured mortgages and thought they would save the cost of the audits (see Finding 3, Attachment 4).

We are recommending that HUD take action necessary to get DB&B, Inc. to either remove itself from all HUD programs, or fulfill its contractual and regulatory requirements. We recommend that HUD:

either allow the owner to prepay the Section 236 insured mortgages, terminate all Section 8 Housing Assistance Payment contracts, and provide Section 8 vouchers to all eligible residents for both properties; or

require the owner to make all repairs necessary at the projects to provide the residents a decent, safe and sanitary place to live, and repay all ineligible and unsupported costs to the projects. If the owner chooses to stay in the HUD programs and is unwilling to voluntarily repair and reimburse the properties, then we recommend that HUD pursue appropriate legal actions against the owner.

We presented drafts of our findings to DB&B, Inc. and HUD on June 18, 1996, and discussed the content of the findings and the recommendations. DB&B, Inc. and HUD both agreed with the findings and recommendations. The owner of DB&B, Inc. stated that he did not require the opportunity to provide written comments to the findings. Therefore, we are issuing this report without obtaining any further comments from DB&B, Inc.

Within 60 days, please furnish us for each recommendation in the report a status report on : (1) the corrective action taken; (2) the proposed corrective action and the date for its completion; or (3) why action is not considered necessary. Also, please furnish us with copies of any correspondence or directives issued related to the audit.

If you have any questions, please contact Jerrald W. Hite, Auditor, at (206) 220-5360.

Table of Contents

Management Memorandum	i
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Attachment 1	1
Background, Audit Objectives, Scope and Methodology	

Attachment 2	3
Finding 1 Available Funds Were Not Used to Provide Decent, Safe and Sanitary Housing	

Attachment 3	7
Finding 2 HUD Requirements Were Ignored And \$23,678 Of Project Funds Were Paid For Inadequate Property Management	

Attachment 4	11
Finding 3 Project Books and Records Were Not Maintained As Required	

Attachment 5	17
Management Controls	

Attachment 6	18
Distribution	

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Background

Western Terrace is a 32 unit Section 236 multifamily property with 7 units assisted under a Section 8 Housing Assistance Payments contract. Western Terrace is located in McMinnville, OR. Colonial Court South is a 40 unit Section 236 multifamily property with 39 units assisted under two Section 8 Housing Assistance Payments contracts. Colonial Court South is located in Albany, OR. Both properties are owned by DB&B, Inc. DB&B, Inc. is a privately owned corporation with one shareholder. The corporation currently has two officers, a President and a Secretary/Treasurer, who handle the operations of these two properties.

We performed this audit at the request of the HUD Portland Multifamily Housing Division. HUD expressed concern over the deteriorating physical condition of the properties, certain financial transactions that had come to their attention, and the project owner's disregard of instructions from HUD to bring the projects' financial records and physical condition into compliance with HUD requirements.

Audit Objectives, Scope, and Methodology

Our audit objective was to determine if DB&B, Inc. operated Western Terrace and Colonial Court South Apartments in accordance with applicable HUD regulations and contractual agreements relating to the concerns expressed by HUD.

Our audit covered the period from July 1, 1993 through January 31, 1996. We performed our work in February and March of 1996. We reviewed financial transactions initiated by the project owner and other unapproved project management hired by the project owner. We reviewed supporting documentation that was provided and represented by the project owner as all documentation available supporting the financial transactions for the period reviewed.

Our audit procedures included but were not limited to:

- Review of HUD project files in the Portland Office,
- Interviews of HUD staff in Portland, former management agents for the properties, personnel at the projects, and the President and Secretary/Treasurer of DB&B, Inc.,
- Obtaining an understanding of the internal control system used by the owner for operation of the projects,
- Review of the workpapers for the last financial audit of the properties, and
- Review of support for financial transactions for the properties.

We conducted our audit in accordance with generally accepted government auditing standards.

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AVAILABLE FUNDS WERE NOT USED TO PROVIDE DECENT, SAFE, AND SANITARY HOUSING

DB&B, Inc., owner of Western Terrace and Colonial Court South Apartments, did not expend available reserve funds to maintain the properties. As a result, the residents of the properties were not provided decent, safe, and sanitary housing. DB&B, Inc. did not use available reserve funds to perform required maintenance because it was holding the funds to prepay the mortgages on the properties.

HUD requires the owner to maintain properties in decent, safe, and sanitary condition.

Section 236 regulatory agreements for both properties require in part that the properties be maintained in good condition. The regulatory agreements for both properties also require the owner to establish reserve for replacement funds. These funds require monthly deposits for use in maintaining the properties and replacing larger items such as roofs and appliances.

The Section 8 Housing Assistance Payment contracts for both properties require the owner to provide decent, safe, and sanitary housing. HUD establishes its Housing Quality Standards for these properties in 24 CFR 886.113. Units in both properties continue under Section 8 Housing Assistance Payment contracts through July 1998 even if the HUD insured mortgages are prepaid.

Western Terrace was not maintained in good condition even though at least \$20,000 was available in reserve funds.

According to CPA workpapers from the last annual audit of Western Terrace, the reserve for replacement balance as of June 1993 was \$28,397. According to HUD records, Western Terrace's reserve for replacement balance as of December 1994, when the last approved management agent was terminated by DB&B, Inc., was approximately \$25,589. Since January 1995, reserve funds of \$8,138 have been used to pay for delinquent mortgage payments; and \$7,183 was used to pay power and light bills so that the utilities would not be disconnected. The only maintenance withdrawal (\$3,630) was made in November 1995 for carpet and vinyl in two units. The Western Terrace reserve for replacement balance as of May 1996 (confirmed with the mortgagee) was \$23,892.

Western Terrace's physical condition was rated as "below average" by HUD in July 1993 and deteriorated to a rating of "unsatisfactory" in December 1995 even though there were over \$20,000 of reserve for replacement funds available to pay for the repairs. The property was also inspected by the mortgagee for Western Terrace in December 1995 and rated "unsatisfactory." The inspection reports we reviewed identified numerous items in need of repair, including violations of HUD's Housing Quality Standards. Two Housing Quality Standards violations identified in July 1993 were still in need of repair in December 1995.

HUD's December 1995 inspection identified serious repair needs including Housing Quality Standards violations. Some of the items identified in inspection reports were:

Finding 1

- The owner's lack of response to items identified in physical inspection reports is jeopardizing the physical integrity of the structure. All exterior items identified in April 1995 are still present.
- Leaking gutter seams above windows causing interior damage and causing exterior T-111 siding to warp and rot.
- Cracked and separated concrete in front of units creating a tripping hazard. This item was originally identified in April 1995.*
- Disintegrating cabinets in nearly all units. Water damaged pressboard, curling veneer, missing drawer fronts and hinges.
- Broken or damaged flooring throughout the property.
- Carpets in poor to hazardous condition. Several units where the carpet is a tripping hazard.*
- Leaking toilets in several units.*
- Inoperable smoke detectors in several units.*

* Violations of Housing Quality Standards.

Colonial Court South was not maintained as required even though the reserve for replacement account balance increased to \$74,030.

According to CPA workpapers from the last annual audit of Colonial Court South, the reserve for replacement balance as of June 1993 was \$42,934. According to HUD records, Colonial Court South's reserve for replacement balance as of January 1995 (when the approved management for Colonial Court South was terminated by DB&B, Inc.) was \$61,359. HUD records show that no withdrawals were made from the reserve for replacement account for Colonial Court South Apartments while under the management of DB&B, Inc. Colonial Court South's reserve for replacement balance as of May 1996 (confirmed with the mortgagee) was \$74,030.

Colonial Court South's physical condition was rated as "below average" by HUD in March 1994 and deteriorated to "unsatisfactory" in June 1995 even though the reserve for replacement fund balance increased from \$42,934 in June 1993 to \$74,030 on May 29, 1996. After an approved management agent was hired in August 1995, an inspection performed in October 1995 by the mortgagee for the property rated the property as "below average". This inspection report noted that the new property manager was attempting to identify problems and resolve them. DB&B, Inc. terminated the property manager at the end of January 1996. All inspection reports reviewed identified numerous items in need of repair including violations of HUD's Housing Quality Standards. One Housing Quality

Standards violation from the March 1994 inspection still existed at the time of the June 1995 inspection.

HUD's inspection of Colonial Court South on April 7, 1996 identified numerous items in need of repair including Housing Quality Standards violations repeated from inspections performed in March and June 1995. Some of the items identified in this report were:

- Raw sewage spillage outside unit 729.*
- Numerous broken windows throughout project.*
- Loose and missing bathroom tiles.
- Carpeting in many units loose, torn, badly worn, and creating tripping hazards.*
- Uneven and broken cement walkways.*
- Rotten wood stairs and railings.*

* Violations of Housing Quality Standards.

DB&B, Inc. was saving reserve funds of both properties to prepay HUD insured mortgages.

DB&B, Inc. did not use reserve for replacement funds to maintain the properties, and allowed conditions such as those described above to persist. As a result, the residents of Western Terrace and Colonial Court South were not provided decent, safe, and sanitary housing as required by HUD. DB&B, Inc. agreed to provide decent, safe and sanitary housing when signing their regulatory agreements and Section 8 Housing Assistance Payment contracts.

According to the officials at both the HUD Portland office and DB&B, Inc., DB&B, Inc. plans to prepay the HUD-assisted mortgages on both Western Terrace and Colonial Court South Apartments. A former management agent for the properties told us that they were told by the sole shareholder of DB&B, Inc. not to use reserve for replacement funds to repair the properties because that was his money and he was going to need it to prepay the mortgages. While prepaying the HUD mortgages relieves DB&B, Inc. of some HUD requirements, Section 8 Housing Assistance Payment contracts, including the decent, safe, and sanitary condition requirements, continue on both properties through July 1998.

In our discussions with officials of DB&B, Inc. and HUD, they agreed that prepayment of the HUD insured mortgages and termination of all Section 8 Housing Assistance Payment contracts is the preferred approach to resolving the issues in this finding. Therefore, we are recommending prepayment of the mortgages provided that DB&B, Inc. terminates all Section 8 contracts on both Western Terrace and Colonial Court South Apartments. We also recommend HUD provide Section 8 vouchers to all eligible residents. If DB&B, Inc. does not prepay the mortgages and terminate all

Finding 1

Section 8 contracts, then HUD needs to abate Section 8 payments until all Housing Quality Standards violations are corrected.

RECOMMENDATIONS:

We recommend that HUD:

- 1A. Allow the property owner to prepay both HUD insured mortgages if all Housing Assistance Payment contracts are immediately terminated.
- 1B. If Housing Assistance Payment contracts are terminated, provide portable Section 8 vouchers to all eligible residents of both properties.

If the owner does not agree to prepay and terminate all Section 8 contracts, then we recommend that HUD:

- 1C. Require the owner to perform all maintenance and repairs necessary to bring the property into compliance with HUD requirements.
- 1D. Abate Section 8 housing assistance payments until all Housing Quality Standards violations are corrected.

HUD REQUIREMENTS WERE IGNORED AND \$23,678 OF PROJECT FUNDS WERE PAID FOR INADEQUATE PROPERTY MANAGEMENT

Contrary to the regulatory agreement, HUD requirements, and specific instructions from the HUD Portland office, DB&B, Inc., owner of Western Terrace and Colonial Court South Apartments, improperly paid management fees to themselves and other unapproved property managers. As a result, \$23,678 of project operating funds were used to pay for inadequate property management. This occurred because DB&B, Inc. intentionally disregarded HUD rules and instructions.

Section 236 regulatory agreements establish limits on the use of project funds.

The regulatory agreements for Western Terrace and Colonial Court South Apartments, which were signed by DB&B, Inc., establish limits on the uses of project funds. The following limitations are established in the regulatory agreements for both properties:

- The owner shall not without prior written approval of HUD pay any compensation, including wages or salaries, to themselves, or any officers, directors, stockholders, trustees, partners, beneficiaries under a trust, or any of their nominees.
- The owner shall obtain and maintain under contract, management approved by HUD.
- The owner shall not without written approval of HUD enter into any contract or contracts for supervisory or managerial services.

Project funds totaling \$13,863 were used to pay DB&B, Inc. and another entity owned by DB&B, Inc. for property management.

Western Terrace had not had HUD-approved management from December 1, 1994 to April 1996. Colonial Court South was without approved management from December 1, 1994 to April 1, 1995, and during the months of July 1995, February 1996 and March 1996. In April 1996 a management agent approved by HUD was retained for both Western Terrace and Colonial Court South Apartments.

In memoranda dated June 27, 1995 for Colonial Court South and July 11, 1995 for Western Terrace, the HUD Portland Office notified DB&B, Inc. that it was required to obtain management approved by HUD. HUD provided a list of suggested management agents for DB&B, Inc. to choose from. The memoranda stated that DB&B, Inc.'s past actions had interfered with prudent management of both properties. Because of the poor physical condition of the properties, failure to use reserve for replacement funds to obtain quality repairs, and extremely poor workmanship on routine repairs, HUD required DB&B, Inc. to obtain professional property management. HUD officials in the Portland Office told us that before written notification was given, DB&B, Inc. was verbally advised on several occasions that it was required to obtain professional management. DB&B, Inc. did obtain an approved manager for Colonial Court South in August 1995; however, no HUD-approved

Finding 2

management was obtained for Western Terrace. DB&B, Inc. terminated the management contract for Colonial Court South as of January 31, 1996.

We calculated that project funds totaling \$13,863 were used to pay DB&B, Inc. and Colonial Court North, a non-HUD insured property owned by DB&B, Inc., for management of the properties during periods when HUD-approved management was not under contract. The only project financial records available and provided by officers of DB&B, Inc. (responsible for management of Western Terrace and Colonial Court South) were files with receipts, check registers, and bank statements. DB&B, Inc. did not maintain proper accounting records (see Finding 3, Attachment 4). Our calculations were based on review of the checks, and the \$13,863 is the total of checks written to DB&B, Inc. and Colonial Court North for what was identified only as “management” on the check, the check carbon, or the check register.

DB&B, Inc. allowed payment of \$9,815 of project funds for unapproved property management.

In 1995 DB&B, Inc. attempted to sell Western Terrace to the Yamhill County Community Development Corporation. In March 1995, prior to the sale being final and without HUD approval, DB&B, Inc. contracted with Yamhill County Community Development Corporation to manage Western Terrace. On July 10, 1995 HUD sent a letter to Yamhill County Community Development Corporation notifying them that their request for approval as management agent of Western Terrace was denied because they did not have the administrative capability to manage a potentially troubled project. On June 30, 1995 DB&B, Inc. informed Yamhill County Community Development Corporation that because the occupancy manager employed by Yamhill County Community Development Corporation had left their employment, they were in violation of their management agreement; the agreement was terminated and DB&B, Inc. would take over management of the property. Western Terrace records show that the occupancy specialist that left Yamhill County Community Development Corporation was subsequently paid directly as management agent of Western Terrace.

Our review of Western Terrace records showed that two checks were paid to Yamhill County Community Development Corporation for four months’ management, from March 1995 through June 1995. The total paid to Yamhill County Community Development Corporation was \$4,794. Western Terrace records also showed that the occupancy specialist who left Yamhill County Community Development Corporation was paid a total of \$5,021 for management of the property. HUD has no record of any application for this person as management agent for Western Terrace and never approved the individual as a management agent. Also, this was the person employed by Yamhill County Community Development Corporation when they applied for approval from HUD as manager of Western Terrace and were denied.

As discussed previously, DB&B, Inc. is required to obtain management approved by HUD. However, DB&B, Inc. chose to retain, and allow payment to, management that was not approved by HUD. Without HUD approval these payments were ineligible uses of project funds.

Services provided by DB&B, Inc. and other unapproved management were inadequate.

Management services provided by DB&B, Inc. were not adequate. For example:

- The properties were not maintained in accordance with HUD requirements, (Finding 1, Attachment 2).
- Project funds were used for ineligible and unsupported expenses, (Finding 3, Attachment 4).
- Project books and records were not kept in accordance with HUD requirements, (Finding 3, Attachment 4).
- Mortgage payments were not always made when due.
- Monthly excess income reports were not submitted to HUD.

As a result of the disbursements to DB&B, Inc., Colonial Court North, and other unapproved property managers identified above, \$23,678 of project operating funds were used to pay for inadequate property management. Based on the results of our review that shows HUD regulations require property management be approved by HUD, and that DB&B, Inc. was notified verbally and in writing that they were required to retain management approved by HUD, we concluded that DB&B, Inc. intentionally disregarded HUD rules and instructions.

In our discussions with officials of DB&B, Inc. and HUD, they both agreed that prepayment of the HUD insured mortgages and termination of all Section 8 Housing Assistance Payment contracts is the preferred approach to resolving the issues in this report. This resolution would be accomplished through recommendations in Finding 1 (Attachment 2). If the owner does not prepay the mortgages and terminate all Section 8 contracts for both properties, then HUD should seek repayment of ineligible management fees.

RECOMMENDATIONS

If the owner does not prepay the mortgages and terminate all Section 8 contracts for both properties, then we recommend that HUD:

- 2A. Require the owner to repay the projects, from non-project funds, for all ineligible management fees paid to itself and other unapproved property management.
- 2B. Require the owner to pay, with non-project funds, for any additional costs charged by new HUD approved management to bring project records into compliance with HUD requirements.

Finding 2

- 2C. Consider pursuing legal action against the owner for double damages under section 421 of the Housing and Community Development Act of 1987, 12 U.S.C. 1715z-4a for using project funds in violation of project regulatory agreements.

PROJECT BOOKS AND RECORDS WERE NOT MAINTAINED AS REQUIRED

DB&B, Inc., owner of Western Terrace and Colonial Court South Apartments, did not properly maintain the books and records, as required for these projects. As a result, DB&B, Inc. could not support that \$69,817 of project funds were used for eligible project expenses. Officers of DB&B, Inc. told us that they had not taken the time to properly maintain project books and records and document that the expenses were eligible. They also said that they had not obtained required financial audits because they planned to prepay the projects' HUD-insured mortgages and thought they would save the cost of the audits.

Section 236 regulatory agreements establish requirements for record keeping.

The regulatory agreements for Western Terrace and Colonial Court South Apartments, which were signed by DB&B, Inc., establish requirements for record keeping at multifamily properties. The following requirements and limitations are established in the regulatory agreements for both properties:

- Books and accounts of property operations shall be kept in accordance with the requirements of HUD.
- Project books and records shall be maintained in condition for audit.
- Audited financial statements are required within 60 days of the fiscal year end.
- The owner shall not without prior written approval of HUD receive any distribution of assets or any income of the project, except from surplus cash, and:
 - at the end of a semiannual or annual fiscal year limited to 6 percent of original equity, and
 - while in compliance with all outstanding notices of requirements for proper maintenance of the property.
- The owner shall not without prior written approval of HUD pay any compensation, including wages or salaries, to themselves, or any officers, directors, stockholders, trustees, partners, beneficiaries under a trust, or any of their nominees.
- The owner shall not without prior written approval of HUD assign, transfer, dispose of, or encumber any personal property of the project, including rents, or pay out any funds, other than from surplus cash, except for reasonable operating expenses and necessary repairs.

Finding 3

Project books and records did not meet the requirements of the regulatory agreement.

At the time of our audit, two officers of DB&B, Inc., the President and Secretary/Treasurer, were performing management duties for Western Terrace and Colonial Court South Apartments. The two officers also were in business together performing tax and accounting services. One of the officers is a Certified Public Accountant. Financial records provided by officers of DB&B, Inc. for Western Terrace and Colonial Court South Apartments included:

- Check books,
- Bank statements,
- Monthly files with paid bills and invoices, and
- Accounting system printouts as of June 30, 1995.

The project records were in boxes in various places at the officers' business offices and at the projects. Project bank statements had not been reconciled since June 30, 1995, and no journal entries or general ledger postings had been made since June 30, 1995. Also, the required annual financial audits for Western Terrace and Colonial Court South for the fiscal year ended June 30, 1995 had not been obtained.

Financial records could not support that \$69,817 of project expenses were eligible.

We reviewed disbursements of project funds made by DB&B, Inc. officers or unapproved management hired by DB&B, Inc. For the period of July 1, 1993 through January 31, 1996, our review identified \$69,817 of disbursements of project funds without adequate support to determine if the funds were used for reasonable and necessary project costs. These disbursements do not include those identified and discussed in Finding 2 (Attachment 3).

\$5,000 of Western Terrace project funds were disbursed to the sole shareholder of DB&B Inc. as a repayment of a loan.

Western Terrace project funds in the amount of \$5,000 were disbursed to the sole shareholder of DB&B, Inc. as a partial repayment of a loan made to Western Terrace. Project financial records included documents showing a deposit of \$15,000 from the sole shareholder of DB&B, Inc. to the Western Terrace operating account. However, Western Terrace files did not contain any loan documents. The project regulatory agreement limits distributions to the end of a semi-annual or annual fiscal year and from surplus cash. Western Terrace's fiscal year end was June 30, 1995. According to accounting records as of June 30, 1995, Western Terrace had a negative cash balance of \$1,140. Therefore, distributions to DB&B, Inc. from project funds were ineligible.

Disbursements of project funds totaling \$12,606 were made to DB&B, Inc., its officers, and another entity owned by DB&B, Inc.

Project funds totaling \$12,606 were paid to DB&B, Inc., its officers, or another entity owned by DB&B, Inc. Of the funds disbursed, \$4,440 were from Western Terrace and \$8,166 were from Colonial Court South. These payments included checks written to:

- DB&B, Inc.'s Secretary/Treasurer for accounting services; yet, as discussed previously, project books and records were not maintained as required by HUD,
- DB&B, Inc. with no supporting documentation or explanation, and
- Colonial Court North, a non-HUD insured property owned by DB&B Inc., for what was identified on the check carbon as a "dividend".

According to the projects' regulatory agreements, the owner shall not, without prior written approval of HUD, pay any compensation to themselves, or any officers, directors, or stockholders. The funds identified above were paid to:

- DB&B, Inc.,
- another business owned by DB&B, Inc.,
- the sole shareholder of DB&B, Inc., and,
- the Secretary of DB&B, Inc.

These payments directly violate this provision of the projects' regulatory agreements and are ineligible uses of project funds.

Project funds totaling \$8,344 were used to pay the personal Discover Card bill of the sole shareholder of DB&B, Inc.

Project financial records show that project funds were used to pay \$8,344 of credit card charges made by DB&B, Inc.'s sole shareholder on his personal Discover Card. Credit card bills and receipts were submitted by the shareholder for reimbursement as project expenses. Review of the receipts identified items such as building supplies, appliances, and office supplies. However, project records did not include any information supporting the need for, or use of, these items at either project. Without adequate supporting documentation we could not determine if these project funds were used for reasonable and necessary project expenses.

The projects' regulatory agreements limit the use of project funds to reasonable and necessary operating expenses and repairs. Without additional support we cannot determine the need for the items purchased or the reasonableness of the costs.

Finding 3

DB&B, Inc., or unapproved management hired by DB&B, Inc., paid \$43,867 of project funds for expenses not adequately supported.

In addition to the ineligible and unsupported costs discussed previously, our review of both projects' financial transactions identified \$43,867 of expenses, paid to individuals or companies other than DB&B, Inc., that were not adequately supported.

Inadequately supported disbursements included purchases from various businesses such as Fred Meyer, Walmart, Bi Mart, local lumber yards, office suppliers, and contractors. There were also checks to individuals, some of whom were identified as onsite employees of the properties. However, no employment agreements were available in the project files. Review of the financial files identified receipts for items such as building materials, appliances, office supplies, and maintenance supplies such as light bulbs and caulking.

Based on our review, the items we included as inadequately supported costs were paid for by check from either Western Terrace or Colonial Court South operating accounts and generally were supported by receipts from the vendor where they were purchased. However, the supporting documents did not include any purchase orders, maintenance requests, or other documents showing a need for the items or what the items were used for at the properties. Without further documentation showing a need for and use of the items for the benefit of the properties, we could not determine if \$43,867 of project funds were used for reasonable and necessary project expenses or repairs.

DB&B, Inc. did not take the time and did not want to go to the expense to maintain proper books and records.

We asked the officers of DB&B, Inc. responsible for management of Western Terrace and Colonial Court South Apartments for all financial records for the properties for the period July 1, 1993 through January 31, 1996. The books and records provided by the officers of DB&B, Inc. did not meet HUD requirements and did not support that \$69,817 of project funds were used for reasonable and necessary project expenses. When asked why books and records were not kept up to date, the Secretary/Treasurer of DB&B, Inc. told us that they had just not taken the time to reconcile bank accounts and maintain accounting records since June 30, 1995. The President of DB&B, Inc. told us that they had not obtained required financial audits because they planned to prepay the projects' HUD insured mortgages and thought they would save the cost of the audits.

In our discussions with officials of DB&B, Inc. and HUD, they both agreed that prepayment of the HUD insured mortgages and termination of all Section 8 Housing Assistance Payment contracts is the preferred approach to resolving the issues in this report. This would be accomplished through recommendations in Finding 1 (Attachment 2). If the owner does not prepay the mortgages and terminate all Section 8 contracts for both properties, then HUD should seek recovery of any inappropriate expenditures.

RECOMMENDATIONS

If the owner does not prepay the mortgages and terminate all Section 8 contracts for both properties, we recommend that HUD:

- 3A. Require the owner to repay, from non-project funds, all ineligible expenses.
- 3B. Require the owner to repay, from non-project funds, all inadequately supported expenses or provide information showing that the expenses were reasonable and necessary expenses of the projects.
- 3C. Require the owner to pay, from non-project funds, any additional costs charged by HUD-approved management for putting the project books and records into compliance with HUD requirements.
- 3D. Consider pursuing equity skimming charges against the owner under Section 254 of the Housing and Community Development Act of 1987, 12 U.S.C. 1715z-19, for ineligible distributions to the owner while Western Terrace was in a non-surplus cash position.
- 3E. Consider pursuing legal action against the owner for double damages under Section 421 of the Housing and Community Development Act of 1987, 12 U.S.C. 1715z-4a, for all ineligible and inadequately supported disbursements made by the owner and unapproved management hired by the owner.

Finding 3

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MANAGEMENT CONTROLS

In planning and performing our audit, we obtained an understanding of DB&B, Inc.'s management controls for the purpose of determining our audit procedures as they related to our audit objectives.

Management control is the process by which an entity obtains reasonable assurance as to achievement of specified objectives. Management control consists of interrelated components, including integrity, ethical values, competence, and the control environment which includes establishing objectives, risk assessment, information systems, control procedures, communication, managing change, and monitoring.

Relevant management controls

We determined that the management control categories relevant to our audit objectives were DB&B, Inc.'s policies, procedures, and practices for ensuring that:

1. Project funds are accounted for properly, and
2. Project funds are used only for reasonable and necessary operating expenses and repairs of the projects.

Scope of Work

We evaluated the relevant control categories above by determining the risk exposure and assessing control design and implementation.

A significant control weakness exists if the controls do not give reasonable assurance that the resources are used in accordance with applicable laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data is obtained, maintained, and fairly disclosed in reports.

Assessment results

Based on our audit, we believe the following items are significant weaknesses:

1. Project funds are not accounted for properly. Since June 30, 1995 DB&B, Inc. has not performed any accounting procedures for the financial activities under the control of the owner for either property.
2. No determination is made for reasonableness, necessity, or eligibility of expenses. DB&B, Inc. pays invoices when received. There are no controls in place to ensure that expenses were reasonable, necessary, or eligible uses of project funds.

Distribution

Director, Multifamily Housing Division, Oregon State Office, 0EHM
Comptroller, Pacific/Hawaii, 9F
Director, Accounting Division, 0AFF
State Coordinator, Oregon State Office, OES (2)
Secretary's Representative, Washington State Office, OAS
Assistant to the Secretary for Field Management, SF, (Room 7106)
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